Resp. Ex. 2.0

ILLINOIS COMMERCE COMMISSION

DOCKET NO. _______

DIRECT TESTIMONY

OF

CRAIG D. NELSON

Submitted On Behalf

Of

CENTRAL ILLINOIS LIGHT COMPANY
CENTRAL ILLINOIS PUBLIC SERVICE COMPANY
ILLINOIS POWER COMPANY

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TABLE OF CONTENTS

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I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is Craig D. Nelson. My business address is One Ameren Plaza, 1901 Chouteau Avenue, St. Louis, Missouri 63166.

Q. What is your relationship to the Applicants in this case?

A. I am Vice President – Strategic Initiatives of Ameren Services Company ("Ameren Services") and Vice President of Central Illinois Public Service Company, d/b/a AmerenCIPS ("AmerenCIPS").

Q. Please describe Ameren Services.

A. Ameren Services is a subsidiary of Ameren Corporation ("Ameren Corp."). Ameren Services provides various administrative and technical support services for its parent and other subsidiaries including Union Electric Company doing business as AmerenUE ("AmerenUE"), Central Illinois Light Company d/b/a AmerenCILCO ("AmerenCILCO"), AmerenCIPS, and Illinois Power d/b/a AmerenIP ("AmerenIP"). Ameren Services was formed in connection with the December 1997 merger of Union Electric and CIPSCO Incorporated.

Q. Please describe your educational background.

A. I earned a bachelor's degree in accounting in 1977, graduating with highest honors, and a master's in business administration in 1984. Both degrees were awarded by Southern Illinois University - Edwardsville. I am a Certified Public Accountant.

Q. Please describe your qualifications.

A. I worked for Arthur Andersen & Co. from 1977 to 1979, when I joined Central Illinois Public Service Company as a Tax Accountant. In 1979, I was promoted to Income Tax Supervisor. I served in various tax and accounting positions until 1985 when I was appointed Assistant Treasurer. In 1989, I became Treasurer and Assistant Secretary, a position I held for seven years. In 1996, I was elected Vice President of Corporate Services. After Union Electric and CIPSCO merged, I was named Vice President, Merger Coordination for Ameren Services effective December 31, 1997. In 1998, I assumed the additional responsibility of Vice President of Regulatory Planning. Effective June 1, 1999, I was appointed Vice President, Corporate Planning. Most recently, effective October 15, 2004, I was appointed Vice President, Strategic Initiatives.

Q. Please describe your duties and responsibilities as Vice President, Strategic Initiatives.

A. My duties and responsibilities include Ameren's business and corporate services initiative, Ameren's post-2006 initiative and power supply acquisition for Ameren's utility companies..

Q. What is the purpose of your testimony?

A. I am testifying on behalf of AmerenCIPS, AmerenCILCO, and AmerenIP (the "Ameren Companies" or the "Companies"). The purpose of my testimony is to present an overview of the Ameren Companies' proposed revisions to its determination of market value, and how that market value will be reflected in rates at the end of the mandatory transition period. In this regard, I will discuss how the Ameren Companies propose to supply and structure their post-2006 regulated electric service offerings to their remaining native load. (I will explain how current Illinois customers of AmerenUE will be affected by this proposal.) In particular, my testimony will: (1) discuss the market developments, regulatory requirements and state policy initiatives in response to which the Ameren Companies developed their market value rider and procurement proposal; (2) summarize the competitive procurement process we propose to obtain supply to full requirements service at regulated rates, how the price the Companies pay for this supply reflects market value, and how the costs of supply will be reflected in bundled retail rates; (3) summarize the benefits of our proposal; and (4) explain why our proposal also is fully consistent with federal standards governing power purchases from affiliated generation companies.

II. BACKGROUND

Q. Why are the Ameren Companies filing for Commission approval of revised tariffs that reflect an auction-based competitive procurement approach ?

A. As Mr. Warner Baxter explains in his direct testimony, we are filing our proposal for a post 2006 competitive procurement process and post 2006 retail tariff for bundled service rates in response to several interrelated market developments, regulatory requirements and state policy initiatives:

1. January 1, 2007 marks the statutory end of the "mandatory transition period" provided under the Electric Service Customer Choice and Rate Relief Law of 1997 (the "Customer Choice Law"), which means, among

other considerations, that both the restructuring-related retail rate freezes and the long-term power supply contracts of the Ameren Companies expire, recognizing as well that the Ameren Companies (with very limited exceptions) no longer own generation in Illinois;

2. As a condition to its acquisition of AmerenCILCO, Ameren Corp. committed to work with the Commission Staff to develop a competitive procurement process for the supply of the native load of AmerenCILCO and AmerenCIPS;

3. The regional wholesale market structure continues to evolve successfully, and provides a meaningful opportunity to implement a highly transparent, competitive procurement process;

4. The Federal Energy Regulatory Commission ("FERC") has imposed increasingly stringent conditions on how utilities can purchase power from affiliated generation companies, which makes it less likely that distribution companies can simply turn to their affiliates for supply as they could and did in the past; and

5. Substantial guidance was provided through the Commission's Post 2006 Initiative, our additional discussions with stakeholders and outside experts, and the review of other restructured states' experience with addressing similar procurement and ratemaking challenges.

A. The Statutory End of the Transition Period

Q. Please explain in more detail the implications of the Customer Choice Law and how the end of its statutory "transition period" affects the rates and supply contracts of the Ameren Companies.

A. The Customer Choice Law initiated: (1) the opportunity for customers to purchase power from the supplier of their choice; (2) a restructuring of the State's electric power industry; and (3) a transition toward delivery service unbundling and greater reliance on market forces to determine how electric power and energy would be provided to retail customers who remain with the utility. As the Commission's recent report on its Post 2006 Initiative to Governor Blagojevich explains, the Customer Choice Law's transition to market forces resulted in "dramatic and positive changes" that have occurred in the industry:

- "Residential customers have benefited from one of the largest and longest rate reductions, and today are paying 20% less than they paid for electricity in 1994. The total savings statewide are estimated to be 3.5 billion dollars.
- Many new entities have entered Illinois to compete for electric supply. Customers have been given the power of choice, and have selected these alternative retail electric suppliers ('ARES').
- Many industrial and commercial customers have realized significant savings from selecting the Power Purchase Option ('PPO') or an ARES; some indicate that these savings have helped them to keep their business in Illinois rather than move to a lower cost state.
- Statewide service reliability has improved dramatically.
- Over 9000 MWs of new generation has been built in Illinois by private investors. These investors, and not customers, have mustered the capital to build these plants and have borne the risk of cost overruns as well as the potential of uneconomic results in stranded costs.

- Illinois utilities have restructured operations by divesting generation, and have become more productive and efficient in order to face the emerging competitive marketplace."[1]

Illinois now approaches the end of its first phase of restructuring. In particular, January 1, 2007 specifically marks: (1) the end of the "transition charges" imposed on unbundled retail rates of several Illinois utilities; (2) the end of the rate freeze for bundled retail service that was imposed on all major utilities; and (3) the end of the long-term supply contracts that most Illinois utilities entered into when, consistent with the Customer Choice Law's requirements and/or Illinois Commerce Commission ("Commission") rules, they sold or spun off their generating assets as part of the restructuring process. The resulting challenges include the post-2006 replacement of expiring power purchase contracts that currently supply the utilities' regulated service options, the structure of these regulated retail service options after 2006, and the nature of utilities' post-2006 service obligations.

In response to these challenges, the Ameren Companies' current filing specifically addresses: (1) how they will procure power for their regulated service offerings to achieve the lowest possible, most competitive price; (2) how their bundled retail rates will be structured to result in stable but market-based prices; and (3) how they will recover their prudently-incurred, market-based procurement costs fairly from each customer class. I will discuss each of these items in Section III of my testimony.

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[1] Final Report of the Illinois Commerce Commission's Post 2006-Initiative to Governor Rod. R. Blagojevich and the Illinois General Assembly, December 2004, p. 1.

B. *Ameren's Central Illinois Light Company Commitment ("CILCO Commitment")*

Q. Please explain the nature of Ameren Corp.'s CILCO commitment.

A. As a condition to its 2002 acquisition of CILCORP Inc., the parent of Central Illinois Light Company (now d/b/a AmerenCILCO), Ameren Corp. committed to work with the Commission Staff to develop a competitive procurement process for supply of the native load of AmerenCILCO and AmerenCIPS subsequent to the December 31, 2006 expiration of their supply arrangements with Ameren generation and marketing affiliates.[2] (Ameren Corp. had not yet acquired AmerenIP.) In making the commitment to utilize a competitive procurement process, Ameren Corp. also agreed to cause AmerenCILCO and AmerenCIPS to seek approval from the Commission for such a procurement process, which would exclude sole supplier arrangements unless specifically authorized by the Commission.

Q. What has Ameren Corp. done to comply with this commitment?

A. To satisfy its CILCO commitment, Ameren Corp. started to meet with Staff to explore options for a competitive procurement process in late 2003. In early 2004, Ameren Corp. integrated its efforts under the CILCO commitment with the Commission's Post 2006 Initiative and has developed a procurement proposal that is consistent with the recommendations received from Staff, the Post 2006 process, and additional stakeholder meetings. As I will explain, the Ameren

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[2] Ameren's RFP commitment is set out in Section F of Appendix A to the Commission's order in Case 02-0428, December 4, 2002. Consistent with the Commission's restructuring policies and orders, supply arrangements of CIPS and CILCO with Ameren generation and marketing affiliates will expire on December 31, 2006.

Companies have developed a proposal consistent with the provisions of the Customer Choice Law that cap power costs as a function of market value (*i.e.*, Sec. 16-111(i)).

Q. Is the Ameren Companies' proposed procurement process consistent with the CILCO Commitment?

A. Yes. The Ameren Companies have developed a competitive procurement process for Commission approval as required under the conditions imposed on the CILCO acquisition. However, in developing its proposal, the Companies have taken into account two important developments. First, retail choice has reduced the demand for the Ameren Companies' regulated supply offerings (e.g., "bundled service")[3] and is expected to continue to reduce the scope of the utilities' power procurement needs as additional customers switch from regulated service to alternative retail suppliers. As the Commission's electric switching statistics show, consistent with the experience in other retail access states, ARES have made significant inroads in the supply of Illinois retail electric customers, particular in the large customer segment.[4] For example, as of December 2004, a total of 32% of the MWh load of large commercial and industrial customers in the AmerenCIPS service area were served by registered RES (including Ameren Energy Marketing Company ("AEM")). For AmerenIP, 48% of large customers'

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[3] The term "bundled service" generally is used in the context of the Ameren Companies' current or post-2006 obligation to provide customers with regulated service options that include both the generation and wires portions of retail supply. Today these regulated service options typically include the utilities' bundled service, a power purchase option, and interim supply service among others.

[4] See "Electric Switching Statistics" as posted at http://www.icc.state.il.us/ec/switchstats.aspx.

December 2004 load was served directly by alternative retail suppliers.[5] Although the utilities remain the supplier of last resort for all retail customers served through their distribution system, the successful introduction of retail access has reduced, and is expected to reduce further, the power supply obligation under their bundled service offerings. Consistent with these regulatory requirements, the Ameren Companies will continue to provide customers with regulated service options.

Second, the scope of procurement needs for post-2006 supply of bundled service has increased due to Ameren Corp.'s acquisition of AmerenIP and the pending transfer of the Illinois service territory of AmerenUE-Illinois ("Metro East") to AmerenCIPS. Although not specifically addressed in the CILCO commitment, Ameren Companies propose to include both the regulated supply needs of AmerenIP and Metro East in the competitive procurement process.

Q. What is the status of AmerenUE's transfer of Metro East to AmerenCIPS?

A. The Commission has approved the transfer of the Metro East plant and business to AmerenCIPS. The Missouri Public Service Commission, by its order of February 10, 2005, has also approved the transfer. I anticipate that the transfer will be completed later this year.

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[5] In addition, a significant portion of AmerenIP's and Commonwealth Edison Company's ("ComEd's") customers have selected the "Power Purchase Option," which is a regulated supply service whose priced is based on a market value index.

C. *Procurement Opportunities Created by Restructured Wholesale Markets*

Q. Please explain how opportunities to implement a highly transparent and competitive procurement process are provided by the regional wholesale market structure.

A. It is important to recognize that the post-2006 procurement for Illinois utilities' regulated service will occur in a substantially evolved wholesale market structure. The Ameren Companies have already completed the transfer of operational control over their transmission facilities to the Midwest Independent Transmission System Operator ("MISO"), one of the two large Regional Transmission Organizations ("RTOs") that serve Illinois. MISO is in process of starting up its hourly energy markets, which are subject to FERC-approved market power mitigation procedures. The introduction of these energy markets, along with MISO-PJM seams coordination and the creation of central/southern Illinois as a MISO trading hub, significantly increase the competitive procurement options available to meet the Ameren Companies' post-2006 supply obligations.

With the introduction of energy markets, MISO will also facilitate competitive procurement through greatly improved transmission access and generation deliverability standards. For example, as currently planned, starting on April 1, 2005, all MISO-internal transactions will be able to utilize network integration transmission service ("network service"), including transactions that span multiple control areas. Also, external resources will only need to obtain firm service to a MISO boundary and, although such scheduling requirements remain for imports from PJM, the MISO-PJM seams coordination effort has already resulted in the elimination of through-and-out rates between the two RTOs. Moreover, MISO has completed the preliminary generation deliverability analyses for its Day 2 energy market and resource adequacy standard. As explained by Mr. Ronald McNamara in his direct testimony in support of this filing, MISO identified over 120,000 MW of generating capacity from designated network resources that will be deemed deliverable (through network service) for the purpose of satisfying participants' resource adequacy requirements within the entire MISO footprint, including central and southern Illinois. All generating units, even those that have not yet passed MISO's deliverability test, will be able to participate in the MISO energy market, subject to MISO's market-based congestion management process. In this market structure, MISO will evolve to be the primary provider of ancillary services to both retail and wholesale power providers in the region and will introduce centralized markets for capacity and ancillary services over the course of the next two years. Mr. McNamara's direct testimony addresses these market developments in more detail.

These developments substantially enhance the efficiency and competitiveness of post-2006 power procurement for retail customers in Illinois. The progress made to date on MISO-PJM market structure initiatives ensures the feasibility and competitiveness of the proposed auction-based procurement of the Ameren Companies' post 2006 supply obligations, and additional developments will serve to further enhance the procurement process.

D. FERC Affiliate Transaction Standards

Q. You also mentioned FERC standards for inter-affiliate power sales. Why are these standards an important consideration in the design of any post-2006 procurement proposal?

A. FERC's affiliate sales standards impose stringent conditions on how a procurement process needs to be structured. These federal standards, which would apply to *any* post-2006 procurement process, require that utilities' procurement processes involving potential purchases from affiliated suppliers must be highly transparent and managed independently. I address these standards, which have evolved considerably since Ameren Corp. first committed to utilize competitive procurement process during the CILCORP acquisition, in more detail in Section V of my testimony. As I also explain in that Section, the proposed competitive procurement process fully satisfies these requirements.

E. Guidance Provided by Commission's Post-2006 Initiative, Stakeholders, and outside Experts

Q. What was the Ameren Companies' role in the Commission's Post-2006 Initiative?

A. The Ameren Companies have been very active participants in the workshops that the Commission organized to address the identified post-2006 challenges. Since the issues that the Ameren Companies have already been working on under its CILCO commitment were essentially the same as those addressed in the Post-2006 Initiative, the Ameren Companies have been able to contribute constructively to this process from the very beginning. In fact, at the very first

Post-2006 Initiative workshop I presented research performed by in-house and outside experts to identify and evaluate available competitive procurement options based on the experience from other restructured states.[6] Since that initial meeting, the Ameren Companies have fully participated in and contributed to each of the six Post-2006 Working Groups: procurement, rates, competitive issues, utility service obligations, energy assistance, and implementation.

Q. How has the Post-2006 Initiative influenced the procurement and retail rate proposal that the Ameren Companies have filed?

A. The Ameren Companies have designed their market value measurement and procurement proposal to take into account the insights and recommendations that resulted from the Post-2006 Initiative. For example, as the Post-2006 Staff Report also notes, the Procurement Working Group developed a list of 18 desirable characteristics for selecting a post 2006 procurement process, which Staff summarized into five overarching policy goals: "(a) mitigation of market structure problems, (b) provision of regulatory certainty for suppliers and utilities, (c) provision of market based prices and rate stability, (d) provision of a straightforward mechanism to convert supply acquisition costs into retail rates using traditional rate design, and (e) provision of a working option by January 2007."[7] As I will discuss in further in Section IV of my testimony, based on the discussions in the Commission's Post 2006 workshops and additional input from Staff, other stakeholders, and consultants, the proposed auction-based

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[6] Craig Nelson, *Power Procurement Post 2006*, April 29, 2004 (as posted at http://www.icc.state.il.us/ec/docs/040503ecPostNelson.pdf)

[7] Post 2006 Staff Report, pp. 3, 7 and 12.

procurement approach was designed so it would to best satisfy these five overarching policy goals and the identified 18 desirable characteristics. In particular, the proposed auction-based competitive procurement process is also consistent with the "Staff's preferred procurement method", which, as Staff recognizes, not only "assures full transparency to all stakeholders" but also "is expected to come the closest" of any procurement approaches to address the concerns of Staff and other parties.[8]

Q. How have the Ameren Companies solicited input from stakeholders and outside experts?

A. The Ameren Companies first met with experts from The Brattle Group in February 2004 to review the procurement models used and the experience gained from other restructured states that have already addressed similar procurement and ratemaking challenges. This review showed that the general structure of our proposal competitive procurement approach is used in many restructured states and almost exclusively in restructured states similar to Illinois. I presented the insights from this review of other states' procurement models at the April 29, 2004 workshop. Mr. Hannes Pfeifenberger's testimony further discusses this review of procurement approaches in other states, a summary of which has also been published as an article in The Electricity Journal.[9] We also sponsored the June 3, 2004 Procurement Working Group presentation of the competitive

[8] Post 2006 Staff Report, pp. 9-10.

[9] Pfeifenberger *et al.*, "Keeping up with Retail Access? Developments in U.S. Restructuring and Resource Procurement for Regulated Retail Service," *The Electricity Journal*, December 2004, pp. 50-63.

procurement model used in Maryland, which in many ways is structured very similar to the New Jersey model.

The review of the experience in other restructured states also showed that the same procurement method frequently is used by all major utilities within a State. Through the Procurement Working Group's discussion of the approaches used by the utilities in Maryland and New Jersey it also became apparent that these two models have found the support of a broad and diverse group of stakeholders. Through these discussions it became apparent to us that the procurement approach utilized in New Jersey was uniquely suited to address the identified post-2006 challenges in Illinois, satisfy the procurement characteristics identified by the Procurement Working Group, and also meet FERC's standards for power purchases from affiliates. Through our participation in the other Post 2006 Initiative working groups, it also became clear that the New Jersey procurement approach would be able to address many of the issues identified and discussed by the other Post 2006 Working Groups.

Q. Have you utilized additional stakeholders' input in the development of its procurement process?

A. Yes. We repeatedly solicited input from Staff, Commonwealth Edison Company, the manager of the New Jersey auction, regional power suppliers, industrial customers, consumer representatives and the Attorney General's office. In June 2004, we met with the manager of the New Jersey auction, Chantale LaCasse of National Economics Research Associates ("NERA"), who is testifying in this proceeding, to discuss the feasibility of applying the New Jersey model in Illinois.

We subsequently developed a whitepaper, "Post 2006 Guidelines and Ameren Competitive Procurement Proposal," that synthesized the guidance and insights we had obtained at that point.

On several occasions from June through September 2004, the Ameren Companies met to discuss their post-2006 guidelines and competitive procurement proposal with the ICC Staff, potential wholesale suppliers of post-2006 service (including, among others, Dynegy, Midwest Gen, Morgan Stanley, Calpine, Goldman Sachs, Select Energy, Constellation, Ameren Energy Marketing, and Exelon Generation), as well as the consumer representatives, industrial customers and the Attorney General's office, as mentioned above. Several of these meetings with Staff and other stakeholders also included ComEd and Dr. LaCasse.

Based on the feedback from these stakeholder meetings, we first updated our whitepaper in early September and, with further guidance through the Commission's Post-2006 Initiative process and additional feedback from Staff and the other stakeholders, developed the details of the procurement and retail rate proposals that we present in this filing. The auction process itself was designed by Dr. LaCasse based on the Illinois market structure and her experience with developing similar auctions in New Jersey and Ohio. The auction process and its development is discussed in more detail in Dr. LaCasse's testimony (Resp. Ex. 6.0).

III. SUMMARY OF THE AMEREN COMPANIES' PROPOSAL

Q. What is the essence of your filing?

A. In essence, "market value" would be based on the results of a Commission-approved Competitive Procurement Auction ("CPA") process and methodology used to translate the Auction outcome into class-specific retail values. Retail rates for Basic Generation Service ("BGS") would reflect the "translated" market values. We hope to receive regulatory approval no later than January 2006. An order in this time frame is needed so that the independent Auction Manager has sufficient time to prepare the auction. Upon approval, the Auction Manager would immediately prepare to hold the first auction for BGS supply in May 2006. Under our procurement proposal, the Commission would monitor the auction with the help of Staff and an independent Auction Advisor retained by the Commission, and, if conducted in accordance to the pre-specified process, the Commission would confirm its results within a few days after close of the auction. The price of the awarded BGS contracts would then be reflected in the BGS component of bundled retail rates based on the pre-specified, Commission-approved rate allocation methodology. The market value would be subject to periodic adjustment, as provided for in the Customer Choice Law. Mr. Robert Mill and Mr. Wilbon Cooper elaborate further on the rate treatment.

To implement this process, the tariff filing addresses three closely interrelated aspects of the Companies' post-2006 bundled service offerings: (1) how they will procure power in wholesale markets for their regulated service offerings to achieve the most competitive price; (2) how the bundled retail rates of regulated service offerings will be structured to result in stable but market-based prices for utility-provided energy; and (3) how they propose to recover their prudently-incurred procurement costs. I will also explain in this section of my testimony the customer protection measures built into this proposal and its consistency with other State policy considerations.

A. Competitive Procurement Process for Post-2006 Supply Requirements

Q. How do the Ameren Companies propose to procure wholesale supply for their Post-2006 bundled service offerings?

A. The testimony of Dr. LaCasse and Mr. James Blessing explain the procurement process in more detail and the filed procurement-related documents—the Market Value Tariff, the Competitive Auction Procurement Rules, and the BGS Supplier Forward Contracts—contain the full specification of the proposed process.

In summary, the Companies[10] propose to use the filed auction process to procure energy and other services from wholesale suppliers for three categories of full requirements products: (1) fixed-priced BGS for residential and small business customers ("BGS-FP"); (2) fixed-priced BGS for large business customers ("BGS-LFP"); and (3) a fixed-price capacity product that, combined with spot purchases of energy from MISO, provides real-time pricing of energy for large business customers ("BGS-Large Service Real-Time Pricing" or "BGS-LRTP"). To provide additional price stability for residential and small business customers, BGS-FP supply will be procured through overlapping three-year contracts where approximately one third of the BGS-FP load is auctioned on an annual basis.

[10] Owing to the pending Metro-East transfer, AmerenUE will not be an Illinois distribution company when the delivery of BGS begins.

The proposed CPA process is modeled after the New Jersey auction process designed, in large part, by Dr. LaCasse, who is expected to act as the independent Auction Manager. All BGS products will be auctioned off concurrently through the proposed "multi-round, descending clock auction", which is recognized as a highly transparent and efficient competitive procurement process that will best be able to address market structure and other procurement-related concerns. Dr. LaCasse's testimony and that of Mr. Blessing discuss product definition and auction design in more detail.

Under the filed procurement process, the Ameren Companies will solicit bids for individual load shares (or "tranches") of full-requirements wholesale electric power supply for each of the three BGS groups to meet the combined regulated service load of the Ameren Companies. Full requirements service means that each supplier is physically responsible for all of the capacity and energy necessary for each of the Ameren Companies to perform its responsibilities as a MISO load serving entity ("LSE") for its regulated retail service customers, and. In addition, each supplier will also be financially responsible for its proportionate share of the ancillary services necessary to serve its portion of the BGS load.[11]. The Ameren Companies will procure network integration transmission ("NITS") service and ancillary services from the MISO. Suppliers only need to arrange transmission services to deliver their supply to the Ameren Companies' control areas.

[11] Ameren will procure the ancillary services but will be reimbursed by the suppliers.

To promote a large set of qualified suppliers, each tranche of BGS supply, defined as a fixed percentage of the procurement group's BGS load, is sized to be only approximately 100 MW of peak load. Once bids are awarded, each supplier would be obligated to supply that fixed percentage of the Ameren Companies' combined retail load at all times regardless of the actual magnitude of the load. This also means that qualified BGS suppliers, not the distribution companies, take on price and volume risks (e.g., customer switching risks) as well as the day-to-day responsibility for resource procurement and portfolio/risk management.

Q. Why do the Ameren Companies propose to combine their power procurement?

A. A combined procurement process for all three Companies is consistent with a wholesale market structure in central/southern Illinois that is reasonably homogenous across the heavily-intertwined service areas of the Ameren Companies. A single procurement process will be able to take advantage of MISO's Illinois trading hub and is also expected to result in greater supply diversity, reduce the relative market shares of individual local generators (e.g., Dynegy and Ameren Corp.'s own generation affiliate), streamline and thus increase the competitiveness of the bidding process, and reduce implementation and ongoing administrative costs.

Q. Why do the Ameren Companies propose to remain LSEs for BGS service?

A. Although most of their obligations as a MISO LSE would be passed on to BGS suppliers through the BGS Supplier Forward Contracts, the Ameren Companies propose that they remain the LSE for two reasons. First, it clarifies that the

Companies remain the providers of last resort for their regulated service customers, which will require the Ameren Companies to supplement and replace BGS supplies in contingency situations such as supplier default. Second, the designation of the distribution company as the LSE also makes clear that the transaction between the BGS supplier and the distribution companies is a wholesale contract, and that the BGS supplier will not be deemed a supplier at retail under Illinois law, which could discourage suppliers from bidding in the auction.

Q. Does the procurement process contain any safeguards and additional measures to protect customers, assure a competitive outcome, and maintain reliability?

A. Yes. The proposed competitive procurement process contains a number of provisions to protect customers, assure a competitive outcome, and maintain reliability.

First, the competitive auction would be monitored by the Commission through its Staff and an independent Auction Monitor. This will ensure a transparent, unbiased bidding process and, like in other states that employ similar approaches, allow for prompt review and confirmation of the auction results by the Commission. We also propose additional safeguards to alleviate concerns over affiliate participation. The Ameren Companies' affiliates would be permitted to participate in the proposed third-party-monitored procurement process subject to additional safeguards: (1) distribution company employees will not be able to participate in the preparation of a bid; and (2) employees from generation or marketing affiliates will not be able to participate in the administration of the procurement process. All existing affiliate transactions and standards of conduct rules will also continue to apply.

Second, the BGS procurement will benefit from MISO resource adequacy standards and market mitigation. For example, MISO's mitigation of spot markets will provide a clear constraint on the pricing of any longer-term supply contracts, including BGS contracts. Due to buyers' and marketers' ability to hedge spot market volatility and arbitrage average price differences between forward and spot purchases, a generator would not be able to sell longer-term bilateral contracts at a price above the (risk adjusted) expected future spot market prices. MISO's market monitoring efforts and automated mitigation procedures to directly address suppliers' ability to exercise market power in spot markets will thus also mitigate purchases under the BGS auction's longer-term contracts. In addition, MISO resource adequacy standards will ensure that sufficient capacity is dedicated to achieve reliable service.

Third, the auction process itself contains a number safeguards, including: a requirement for suppliers to provide indicative offers; scaling of the procurement process to avoid bid insufficiency; contingency procurement provisions under which energy can be purchased through power purchase agreements, for limited periods, directly from MISO spot markets; and load caps under which no more than 50% of the Ameren Companies' combined fixed-priced BGS products and no more than 50% of Ameren Companies' BGS-LRTP product can be awarded to a single bidder in a given auction. As Dr. LaCasse explains further in her testimony, similar safeguards have been employed successfully in New Jersey.

Fourth, the proposal also contains a number of measures to reduce supplier default risks. We will establish and maintain a website for communicating with bidders and for providing access to pertinent data to facilitate bidders' evaluation of their supply obligation (e.g., available historical loads, load research, and retail switching information for each BGS procurement group). This information will not only reduce bidders' costs of participating in the CPA, but will also reduce the risk of suppliers misjudging their supply obligations that, ultimately, could lead to supplier default. But, importantly, we propose to promote reliability and protect customers through explicit supplier prequalification and credit requirements, including:

- Signed confidentiality agreement;
- Qualification as MISO market participant in good standing;
- Any and all necessary authority to sell at the designated price;
- Provision of credit and financial information to allow assessment of creditworthiness and financial capability in accordance to pre-specified risk management criteria;
- A binding bid agreement and provision of bid assurance collateral; and
- After BGS supply contracts are awarded, posting of additional collateral is required based on mark-to-market accounting of the contract and the supplier's credit rating.

The procurement processes in New Jersey and Maryland provide detailed examples of similar pre-specified and commission-approved supplier prequalification requirements that have resulted in the reliable, competitive supply of utilities' regulated service.

Q. **How would the Ameren Companies procure power in the event that one of the BGS suppliers defaults?**

A. To protect customers against (however unlikely) cases in which a supplier defaults on its obligation after bids have been awarded, we propose to replace the defaulted on contract using a pre-defined process. This process is described in detail in the direct testimony of Mr. James Blessing.

Q. **Do the proposed procurement and retail rate proposals maintain Commission oversight?**

A. Yes they do. Although our CPA proposal greatly streamlines the regulatory process, it would also maintain Commission oversight. Under our proposal, the Commission will: (1) approve the procurement methodology and process before the auction takes place; (2) closely monitor compliance with the approved procurement process with assistance of an independent Auction Advisor; (3) be able to initiate an investigation of the auction outcomes if the procurement was not conducted in compliance with the process; (4) approve the BGS rate structure for the Ameren Companies' and the rate allocation methodology used to translate the procurement costs into retail rates; (5) approve the market value adjustment factor; (6) approve the contingency plans that describe the process the Ameren Companies will use to purchase any BGS supply not obtained through the auction process and (7) approve any proposed prospective changes to the procurement process. Of course, the Commission also continues to have full regulatory oversight over the Delivery Service ("DS") rates and the DS component of bundled service rates. The Commission will also fully retain its ability to implement potential future energy policy options, such as renewable resource standards or energy efficiency and low income programs.

Q. What is the process under which the Commission will approve supply contracts selected through the auction process?

A. If the Commission approves the proposed CPA, the auction will be conducted strictly in accordance with the auction rules. Under this process, the contracts awarded through the auction would be presumed prudent and their full costs would be recovered in rates as long as the procurement process was adhered to.

More specifically, the proposed Rider MV provides for prompt post-auction consideration of the auction results by the Commission. Only if the Commission concludes that grounds exist to initiate and investigation or complaint concerning the auction outcome, it would notify the Ameren Companies, trigging the pre-specified contingency provisions. In deciding whether to issue a notice of investigation or complaint, the Commission, in consultation with its Staff and the Auction Advisor, would consider if the competitive procurement has been conducted in accordance with the approved procurement process and whether there was unambiguous evidence that the auction outcome has been manipulated.

If no such action is taken by the Commission within three days following notice of the end of the auction from the Auction Manager, the auction-determined procurement costs should be deemed prudent for the purpose of full cost recovery in retail rates. At that point, the Ameren Companies would proceed with the acquisition of supply from the pre-qualified successful bidders.

Q. Why is it important that the auction be deemed final so quickly after the auction closes?

A. Bidders will not accept an open-ended process. If bidders knew that the auction were subject to a lengthy post-auction review, they would either be less likely to bid, or would increase their asking price if they did bid, to reflect the greater risk to them. Power suppliers with capacity to sell seek certainty. As Mr. Pfeifenberger also explains in his testimony, the almost immediate approval of auction outcomes is also consistent with the approval process in other restructured states.

B. Structure and Determination of Post 2006 Retail Rates for Bundled Service

Q. How do the Ameren Companies propose to determine and structure retail rates for Post-2006 bundled service?

A. As explained in the testimony of Mr. Cooper, Ameren proposes to transition its bundled services to new tariffs that combine a BGS component with its current DS rates. These BGS and DS components are proposed to be "bundled" into a single tariff offering for regulated service similar to the current bundled tariff offerings. However, as recommended in Staff's Post- 2006 Report, the BGS and DS components of the bundled service offerings will be shown separately on customer bills to facilitate comparison of bundled service rates with unregulated retail service offered by alternative retail electric suppliers. The DS component of the Ameren Companies' post-2006 bundled service tariff would be based on the distribution companies' applicable DS rates on file with the Commission and each of the current rate classes for bundled service would be assigned to the appropriate DS rate class.

Similar to the structure of DS rates, we propose to reduce the number of service rate classes with respect to the BGS rate component. As Mr. Cooper explains in more detail, the Ameren Companies would offer a fixed-priced retail rate structure option for each of the residential, small business, intermediate business, outdoor lighting and large business customer classes. As also explained in Mr. Cooper's testimony, the new BGS-based retail rate classes are proposed to be uniform across Ameren's distribution companies.

Q. How will the rates for bundled retail service be determined for individual rate classes within each auction procurement group?

A. We have developed for the Commission's approval the rate allocation formulas that would be used to translate the auction clearing price for BGS-FP, BGS-LFP, and BGS-LRTP into the filed rate structures of the bundled service tariffs. As explained in Mr. Cooper's testimony, these rate allocation formulas apportion the auction's market clearing prices to ratepayers according to their respective load factors and other load characteristics to reflect the different contributions of customers to procurement costs. As further explained, the rate allocation formulas also seasonally differentiate customer rates based on the pre-specified factors. In many respects the BGS rates are designed to consider a number of the same cost causation factors that are reflected in current bundled rates.

Under this process, we would submit to the Commission updated retail charges determined with the Commission-approved rate allocation formulas concurrently with the signing of BGS supply contracts. As explained in Mr. Mill's testimony, in addition to rates determined directly from the auction outcome, the BGS component also includes an "Adjustment Factor" to true up expected small differences between BGS revenue collected from retail customers and the total BGS procurement costs incurred by the distribution utilities.

C. Cost Recovery

Q. How will the Ameren Companies recover the cost of procuring power for the supply of BGS service?

A. The total BGS-related costs recovered in rates would include: (1) the BGS supply costs under the awarded BGS contracts); (2) labor, consulting and administrative and general, capital and other costs related to power supply procurement and (3) the additional costs, if any, that the Ameren Companies would incur if they had to purchase supplemental BGS supplies as the result of certain contingency provisions. Such contingency purchases would be required as a result of supplier default or if sufficient resources could not be solicited through the auction. This cost of contingency power purchases for BGS supply, if any, may include the incremental costs of temporary purchases from MISO spot markets or the cost of replacement power purchase agreements. Any contingency power supply costs would be recovered through a separate charge to BGS customers, as explained by Mr. Mill.

D. Consistency with State Energy Policy Initiatives

Q. Can the proposed CPA accommodate potential future Commission policies and/or legislative mandates on subject matters such as energy efficiency, low income, or renewable resource programs?

A. Yes. Any such energy policy objectives can easily be accommodated under our Post-2006 framework. In the case of potential future state-wide renewable resource standards, for example, distribution companies could simply integrate the resource standard into their BGS procurement process so that the renewable resource requirement becomes a wholesale portfolio management responsibility for all wholesale suppliers of BGS service. Energy efficiency programs could be implemented as a state-wide initiative that is funded through a non-bypassable surcharge on all energy delivered through all Illinois utilities. Similarly, low income programs could be implemented on a utility-wide basis through surcharges on all energy delivered over the company's distribution system (i.e., regardless of whether the service is provided by the utility or alternative retail providers). To the extent that the State or the Commission entertains policy initiatives such as renewable resource, low income, or energy efficiency programs, we strongly recommend that their design and implementation be state-wide in scope and be applied to all retail/wholesale suppliers operating in Illinois so that the burden of any such initiatives does not fall predominantly on the utilities' regulated service customers. Similarly, State and Commission policy (as they affect utility cost recovery and rate design) must ensure that RTO-related costs and compliance with RTO requirements do not become the primary responsibility of the Illinois utilities and their regulated service customers, but are borne uniformly by all retail and wholesale suppliers. This applies, for example, to regional resource adequacy requirements.

IV. BENEFITS OF THE POST-2006 PROPOSAL

Q. What are the benefits you have identified in the selection and development of the proposed procurement approach?

A. Our proposed procurement process for the Companies' Post-2006 supply of regulated service provides a number of significant procurement-related benefits, maintains Commission oversight, promotes reliability, and protects customers. Compared to other procurement options, the proposed "vertical tranche" approach also offers a more transparent, less contentious process, provides a better allocation of risk, offers increased efficiency at predictable retail rates, and is the predominant approach used in other retail access states facing similar policy issues.

The procurement process meets the goals of restructuring legislation, is consistent with FERC affiliate sales policies, and, importantly, also satisfies the CILCO Commitment—namely that the Ameren Companies would use a competitive procurement process for their Post-2006 supply of regulated service load. As the Commission noted in its Final Post-2006 Initiative Report to Governor Blagojevich, "[a] competitive procurement process will deliver the most efficient pricing to customers over the long run."[12]

[12] Final Report of the Illinois Commerce Commission's Post 2006 Initiative To Governor Rod. R. Blagojevich and The Illinois General Assembly, p. 3.

Our proposal to bid out shares of full requirements service is exceptionally transparent because the procurement of standardized supply products (i.e., vertical tranches) allows for the full pre-specification and pre-approval of the procurement and evaluation process without the need to apply additional judgment or require additional negotiation during the bid selection process. This means all price, non-price, and bid evaluation issues can be fully resolved, specified, and approved prior to conducting the auction. The regulatory certainty, the transparency, full pre-specification, and small size of individual tranches also increase competition by promoting participation of a wide, diverse group of suppliers.

The vertical tranche method of bidding out shares of full requirements service efficiently utilizes the portfolio and risk management capabilities of experienced wholesale market participants and avoids duplication of active portfolio management functions within the regulated distribution companies. In other words, the approach allows the regulated distribution utilities to focus on what they do best (i.e., distribute power to end users) while allowing wholesale suppliers to focus on what they do best (i.e., take on all generation-related responsibilities, such as risk management and assembling and managing their least-cost resource portfolio) to supply power at the fixed contractual terms defined in the procurement process.

Our proposed procurement process results in market-based pricing while maintaining safety net service and protecting customers from undue wholesale market volatility. In particular, the proposed portfolio of overlapping three-year supply contracts provides stable rates for residential and small business customers, while still sending price signals that adequately reflect current market prices. The annual fixed-price contracts for large customers also provide stable, market-based rates that can easily be compared with offers from other alternative retail electric suppliers. Market-based pricing that allows a straightforward comparison of choices for consumers further facilitates the development of retail competition.

The full pre-specification of the procurement process not only increases transparency, which is particularly important in the context of participation by affiliated suppliers, but it also results in a streamlined, less complex, less contentious regulatory process. At the same time, as I discussed in the prior section of my testimony, the process also maintains full Commission oversight and allows for the continued stakeholder input on improving the procurement process over time.

Our proposed CPA benefits customers by enhancing competition between wholesale suppliers to achieve the best possible price for the reliable supply of the utilities' remaining regulated service obligations. This proposal also promotes diversity of supply, reliability, and customer protection by: (1) allowing participation by a large, diverse set of wholesale suppliers; (2) imposing supplier pre-qualifications and credit quality requirements; and (3) explicitly specifying conditions and procedures to fill any supply shortfalls that may occur during the auction process or as a result of supplier defaults.

The proposed procurement process has an established track record in other restructured states. For example, as discussed further in the testimony of Mr.

Pfeifenberger, the approach to bid out vertical tranches of full requirements contracts has been prescribed as the default methodology for post-rate-freeze procurement of regulated retail service in Ohio and is already being used successfully to supply regulated generation service in other states that have undergone restructuring similar to that experienced in Illinois: New Jersey, Maryland, the District of Columbia, Rhode Island, Connecticut, Massachusetts, Maine, and Texas.

Finally, the proposed auction design has been used successfully in New Jersey for four years. Most recently, the auction format also was successfully used in Ohio as a means to verify that FirstEnergy's proposed affiliate supply contract did not exceed market prices. The FirstEnergy auction was able to solicit sufficient supplies despite an adverse environment marked by the facts that FirstEnergy itself did not bid any supplies into the auction, that the auction was held more than one year ahead of the contracts' delivery date, and that it was conducted before MISO implemented its "Day 2" energy markets and related market designs.

Q. **What are the benefits of your proposal with respect to retail rate making?**

A. Ameren's proposal streamlines retail ratemaking in several ways. First, it provides a clear pre-specified mechanism for translating the results of the procurement process into retail rates. This also reduces the uncertainty faced by wholesale suppliers as they will know at the time of the auction how the auction results will affect retail rates, which allows an assessment of how much load would likely switch to alternative retail suppliers. Second, by providing a fully pre-specified Commission-approved process, bidders can be confident that the results of an approved auction process will be accepted. It provides further regulatory certainty in the form of full cost recovery to the utilities if they follow the Commission-approved procurement approach. Third, as discussed above, the proposed process also offers the benefit of full compatibility with future Commission policies and/or legislative mandates on subject matters such as energy efficiency, low income, or renewable resource programs.

Q. You mentioned the importance of stable, market-based rates for customers. Why are market-based retail rates desirable?

A. Post-2006 bundled rates that reflect the cost of purchasing power at competitive market prices are important for a number of reasons. Stable but market-based rates provide proper price signals that allow customers to make more efficient choices regarding their consumption of electricity, their investment in energy-intensive equipment, their selection of fuel for home heating applications, and their selection of service offerings alternative retail electric suppliers (e.g., green power options or innovative pricing plans). The latter is particularly important if the retail access and the creation of a level playing field for retail competitors continue to be a policy objective in Illinois.

Q. You explained earlier in your testimony that your proposed CPA was designed consistent with guidance received through the Commission's Post-2006 Initiative. Does the procurement process satisfy the 18 desireable characteristics identified by the Post-2006 Initiative's Procurement Working Group?

A. Yes, it does. As explained by Mr. Blessing, Ameren's procurement approach satisfies all eighteen desirable characteristics identified by the Procurement Working Group.

Q. Is the proposed CPA consistent with the recommendations that Commission Staff's made based on its participation in the Commission's Post-2006 Initiative?

A. Yes, based on various meetings with Staff and the December 2, 2004, Post-2006 Staff Report, I believe it is. As Staff noted in its Post-2006 Report:

- Staff believes that the vertical tranche auction "is expected to come the closest to possessing the majority of [the Procurement Working Group's] 18 desirable characteristics" which Staff has organized into five overarching policy goals. Staff also concludes that vertical tranche auctions "can best achieve these five overarching policy goals: mitigation of market structure problems; provision of regulatory certainty; provision of market based prices and rate stability; provision of a straightforward mechanism to convert supply acquisition costs into retail rates using traditional rate design, and provision of a working option by January 2007."[13]

- The vertical tranche auction, which "assures full transparency to all stakeholders,"[14] is Staff's "preferred procurement method" for large electric utilities, such as Ameren or ComEd, "that own little to no generation capacity (having spun off most or all of their generation assets)."[15]

- Staff finds that the vertical tranche auction approach would "best mitigate" identified affiliate and market power concerns, and "is expected to come the closest" of any procurement approaches to addressing the concerns of Staff and other parties.[16] Staff finds that "the transparency of the vertical tranche auction is its central strength" and that it "should result in as

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[13] Post-2006 Staff Report, p. 3 (see also pp. 7 and 12).

[14] Post-2006 Staff Report, p. 9.

[15] Post-2006 Staff Report, p. 10.

[16] Post-2006 Staff Report, p. 10.

competitive and outcome as is possible given the underlying concentration of generation assets."[17]

- Staff further notes that "the transparency of the auction process also serves to reduce the risk of after-the-fact prudence review of individual contracts. The auction, rather than the utility, determines how much suppliers are paid and how much they supply toward meeting bundled load. This reduces the need to scrutinize utility decisions and potential favoritism toward affiliates. In addition, the use of a State-approved bidding process, such as a vertical tranche auction, addresses FERC requirements for arm's length transactions between utilities and their wholesale affiliates."[18]

- "Since the auction's structure and procedures would be vetted and approved by the Commission prior to the auction's actual execution, acceptance of the auction's final results should be fairly routine." As Staff notes, "if the auction is structured correctly, unreasonable prices are not possible, almost by definition."[19]

- The use of a vertical tranche auction is also consistent with one of the main policy goals, the transition to stable but market-based prices for utility-provided energy.[20] Staff recognizes that the procurement plans' "overlapping multi-year full requirements contracts with suppliers ... enables the utility to provide a market-based but significantly stable price for small customers."[21] Such market-based pricing of regulated service is important because "without appropriate price signals, customers may not be able to make well-informed strategic decisions regarding their long-term investments in energy-intensive equipment."[22] It is also important for creating a level playing field for alternative retail service providers in particular because "[m]arketers will find it easier to compete against contemporary market-based prices than [the existing] pre-1997 cost-based rates."[23]

- Staff stresses that "[a] vertical tranche auction poses no special problems for retail ratemaking. [The auction results] can be easily converted into electric rates for individual customer classes. Furthermore, ... renewable portfolio standards [as well as] the objectives of fuel diversity, demand response requirements, or programs designed to help low income

[17] Post-2006 Staff Report, p. 12.

[18] Post-2006 Staff Report, p. 14.

[19] Post-2006 Staff Report, pp. 13-14.

[20] Post-2006 Staff Report, p. 12.

[21] Post-2006 Staff Report, p. 15.

[22] Post-2006 Staff Report, p. 14.

[23] Post-2006 Staff Report, p. 33.

consumers pay their utility bills can be pursued within the context of an auction process.'[24]

- Staff further states that "[t]he transparency and liquidity of the markets made possible via regional ISOs will serve to provide, relative to more traditional markets found in the Midwest, a far greater number of resources that can be drawn upon to efficiently serve and support load. Providing a market where geographically diverse generators must compete on a daily basis to provide power to the grid reduces the relative importance of what might otherwise be local monopolies."[25]

- Finally, Staff notes that the auction process reflects the lessons learned from other states and is a solution that likely "could be in place before January 2007. Notably, New Jersey has been successful in implementing [such an] auction annually for the last three years. The results of the auction have been found to be reasonably competitive and acceptable by the New Jersey's Board of Public Utilities every year since the auction's inception. Other states are using the New Jersey auction as a blueprint for their own plans to obtain supply for bundled service."[26]

Q. Have the success and benefits of the New Jersey auction design also been recognized by those involved in New Jersey's procurement process?

A. Yes. The testimony of Dr. LaCasse, who managed the New Jersey auctions since their inception, discusses the success and benefits of this approach in greater detail. As she explains, the uniform-price and multi-round nature of the proposed auction format is broadly recognized to increase the efficiency of the procurement process and to determine market prices most reliably. As New Jersey Commissioner Frederick Butler specifically noted in his April 29, 2004 presentation at the Commission's Post-2006 Symposium, the advantage of New Jersey's multi-round, uniform-price auction format for basic generation service include:

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[24] Post-2006 Staff Report, p. 15.

[25] Post-2006 Staff Report, p. 17.

[26] Post-2006 Staff Report, pp. 15-16.

- "Efficiency – BGS is supplied by the lowest-cost bidder;
- Lowest price – leads to lowest possible price for BGS supply;
- Market value – leads to BGS prices that reflect market forces;
- Proper risk sharing – risk is borne by those who can manage it at lowest costs;
- Transparency – leads to more aggressive bidding;
- Objective and fair – attracts more bidders and minimizes post-auction challenges."[27]

V. CONSISTENCY OF AMEREN'S PROCUREMENT PROPOSAL WITH FERC AFFILIATE TRANSACTION REQUIREMENTS

Q. First, before considering the FERC rules or protocol, is it important that the Companies' wholesale marketing affiliate be able to participate in the auction?

A. Yes, for following reasons. First, having more suppliers is good for customers. More suppliers mean more competition, and more competition means lower prices. Second, the utilities' affiliates may be more competitive in bidding. To deprive the affiliates of the right to participate can lead to higher prices than otherwise. This is so not only because the affiliates are not competing but other suppliers may change their ultimate bid price knowing the affiliates are not competing.

Q. Does the CPA retail rate proposal require the approval of the FERC?

A. FERC does not regulate retail electricity sales, so the Ameren Companies do not require the FERC's approval to implement its procurement and retail rate proposal. The Commission has exclusive jurisdiction over the retail prices

[27] Butler Presentation, p. 8.

charged to Illinois retail customers and therefore must approve how the prices resulting from the auction are translated into retail rates.

FERC, however, has exclusive jurisdiction over wholesale power sales, so any party awarded a supply contract through the proposed procurement process will require FERC approval before it can begin such sales. (Most, if not all, of the parties expected to participate in the procurement process, however, already have pre-authorization from FERC to sell power at market-based rates.) In addition, a long-term (one year or longer) wholesale power contract between the Ameren Companies and affiliated generation on wholesale marketing companies must meet certain guidelines and requirements to receive FERC approval.

Q. What is the significance of FERC's review of such inter-affiliate power sales agreements?

A. Given the nature of generation ownership in Illinois today, affiliates of the Illinois operating companies likely will supply part of the generation needed for post-2006 service regardless of the procurement method chosen. Failure to take account of FERC policies on inter-affiliate power sales agreements may result in FERC modifying or rejecting an inter-affiliate sales agreement entered into pursuant to the procurement process and force the Ameren Companies to "redo" the auction and/or buy power on the spot market. Such regulatory uncertainty is best avoided by designing the procurement process in a way that prevents any affiliate abuse, so as to alleviate any concerns FERC may have in the future.

Q. Do the affiliated generation and marketing companies plan to participate in the proposed auction for basic generation service by the Ameren Companies?

A. It is my understanding that AEM, which markets power for Ameren's generating companies, plans to participate in the auction to serve load in the service areas of Ameren's Illinois operating companies (i.e., AmerenCIPS, AmerenCILCO, and AmerenIP). It is also my understanding that, if ComEd holds an auction, and uncommitted generation resources are still available to AEM, AEM is also planning to participate in that auction as well.

Q. Why does the FERC have specific guidelines and requirements for purchase power agreements ("PPAs") between affiliated companies?

A. FERC is concerned about the potential for "self-dealing" when a utility purchases power from an unregulated affiliate. Such self-dealing potentially could harm both the utility's retail customers and wholesale competition. For example, when a utility purchases power from an affiliate not subject to cost-of-service regulation, the buyer may have an incentive to favor its affiliate even if the affiliate is not the least-cost supplier, because the higher profits (from the above-market purchase) would accrue to the seller's shareholders. FERC is concerned that purchasing power at an above-market price from an affiliate would not only harm the purchasing utility's retail customers (an issue which is under the exclusive jurisdiction of state regulatory commissions) but that such deals would also harm wholesale competition by reducing the market share of non-affiliate sellers and generally discouraging their entry into and participation in the wholesale market.

Q. What evidence is an applicant required to submit to FERC to demonstrate that a PPA with an affiliated company is not the result of self-dealing or other affiliate abuse?

A. The FERC's current standards for power sales between affiliates evolved from the guidelines established in its 1991 Edgar order.[28] In Edgar, the FERC held that, in analyzing market-based rate transactions between an affiliated buyer and seller, it must ensure that the buyer has chosen the lowest cost supplier from among the options presented, taking into account both price and non-price terms. The FERC set forth several ways for a utility to show that it did not unduly favor an affiliate. One type of evidence is "direct head-to-head competition between [the seller] and competing unaffiliated suppliers either in a formal solicitation or in an informal negotiation process."[29] Such evidence is reviewed by the FERC to ensure that: "(1) the solicitation or negotiation was designed and implemented without undue preference for the affiliate, (2) the analysis of the bids or responses did not favor the affiliate, particularly with respect to evaluation of nonprice factors, and (3) the affiliate was selected based on some reasonable combination of price and nonprice factors."[30]

If a competitive solicitation is not used, an affiliate sale can be justified on the basis of a "benchmark analysis".[31] A benchmark analysis compares the prices, terms, and other conditions of the affiliate power sale to other contemporaneous power sales of the same product in the same geographic market

[28] Boston Edison Co. Re: Edgar Electric Energy Co., 55 FERC ¶ 61,382 (1991) (Edgar)

[29] *Id.* at 61,168.

[30] *Id.*

and of a similar duration. A third type of evidence that an applicant could provide would be the prices that non-affiliated buyers were willing to pay for the similar services from the seller.[32]

Q. Over the past few years, has FERC extended the <u>Edgar</u> standards to additional transactions?

A. Yes. In the "<u>Mountainview</u>"[33] order issued February 25, 2004, FERC announced that it would extend the <u>Edgar</u> provisions to all long-term inter-affiliate PPAs, regardless of whether the agreements were at cost-based rates or market-based rates. FERC reasoned that doing so will not only "protect wholesale power customers," but also will identify and combat affiliate preferences that "could discourage non-affiliates from adding supply in the local area, harming wholesale competition."[34]

On July 29, 2004, in an order approving the sale of two generating facilities from AEG to AmerenUE, FERC stated that it would, in the future, also apply the <u>Edgar</u> standards to intra-corporate asset transfers.[35] Thus, the sale of a generating facility from a merchant entity to its affiliated load-serving utility now must meet the <u>Edgar</u> standards to demonstrate the absence of affiliate abuse.

Q. Has FERC recently modified or clarified any other aspect of the <u>Edgar</u> standards?

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31 *Id.* at 62,169.

32 <u>Id</u>.

33 <u>Southern California Edison Co. on behalf of Mountainview Power Co., LLC</u>, 106 FERC ¶ 61,183 (2004).

34 <u>Id</u>. at PP 58-59.

35 <u>Ameren Energy Generating Co.</u>, 108 FERC ¶ 61,081 (2004) (*Ameren*).

A. FERC has not modified the Edgar standards but recently provided additional guidance on the kind of competitive solicitation process that would enable an applicant to satisfy the Edgar standards. According to FERC, a competitive solicitation process needs to adhere to four principles:

(1) Transparency: the competition should be open and fair;

(2) Definition: the product or products sought through the competitive solicitation should be precisely defined;

(3) Evaluation: evaluation criteria should be standardized and applied equally to all bids and bidders; and

(4) Oversight: an independent third party should design the solicitation, administer bidding, and evaluate bids prior to the company's selection.[36]

FERC explained that the transparency and oversight principles apply to all aspects of the competitive solicitation whereas the definition principle applies in the design of the solicitation and the evaluation principle applies as bids are evaluated.[37]

Q. Does your procurement proposal meet the four principles that FERC has established for competitive solicitations?

A. Yes. The proposed procurement process clearly meets each of the four principles set forth by FERC. The procurement process will be highly transparent; the products sought will be precisely defined; pre-specified standardized evaluation

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36 See Allegheny Energy Supply Company, LLC, 108 FERC ¶ 61,081 at P 22 (2004) (Allegheny).

37 Ameren at P71.

criteria will be used to select bidders and bids; and an independent party designed the solicitation, will administer the auction, and evaluate and select the bids.

With respect to transparency, all relevant information about the auction will be made available on a publicly viewable website managed by the independent Auction Manager. This website will contain the prequalification requirements, detailed auction and bid selection rules, the supplier contracts, and all other information necessary for bidders to participate effectively. In addition, the Auction Manager will hold bidder information sessions open to any interested party.

With respect to clear product definition, all bidders will be competing for a fully standardized product—a vertical "slice" or "tranche" of Ameren's retail load. The Supplier Forward Contracts will spell out in detail the product terms and conditions for all potential bidders. The use of standard contracts allows any potential bidder to compete on a level playing field with any other bidder.

The proposed solicitation will fulfill FERC's third guiding principle, standardized evaluation. The auction will reveal a clear, unambiguous price for each product. Winners will be selected under the auction rules based on price alone because all bidders will be supplying the product under the same non-price terms. In addition, the auction provides for a pre-auction bidder qualification process to assure that all potential bidders meet certain stipulated minimum requirements. Finally, the auction process itself means that no post-bid negotiation will take place, which further ensures fair and equal treatment of all bidders.

Finally, the proposed solicitation will also comply with FERC's fourth guiding principle, independent oversight. As I explained above, the auction has been designed by and is expected to be managed by Dr. LaCasse of NERA, an independent third party. The Auction Manager will have no financial interest in the bidders and will not be paid based on the outcome of the auction. The auction manager will ensure that the guidelines and rules of the auction are followed in an unbiased manner. By controlling the flow of information from potential bidders to Ameren, the Auction Manager can and will deny Ameren access to any information that might give an unfair advantage to its affiliates, thereby preserving the integrity and fairness of the auction process. In addition, the Commission will retain, with expenses paid through the auction process, an independent Auction Monitor to monitor the auction under Commission oversight. This Auction Monitor will then report to the Commission to certify that the auction process has been followed or notify the Commission of any observed irregularities.

Q. Has the FERC approved affiliate PPAs that resulted from competitive solicitations similar to that being proposed by Ameren?

A. Yes. As I explained above, the proposed competitive solicitation is modeled closely on the auction that New Jersey's utilities have used over the past several years to procure basic generation service ("BGS"). Utility affiliates have been among the winning bidders in the last two BGS auctions. In an order issued January 30, 2003, FERC approved an affiliate power sale between Consolidated Edison Energy and Rockland Electric Company made pursuant to New Jersey's

BGS auction, finding that "*[t]he BGS competitive bid process described by Applicants alleviates the Commission's concerns regarding affiliate abuse.*"[38]

In 2004 FERC similarly approved Allegheny Energy Supply Company's request to sell power to an affiliated utility company, Potomac Edison. This sale was made pursuant to the competitive procurement of standard offer service in Maryland.[39] Maryland's competitive procurement process was very similar to the auction used in New Jersey (and that proposed now by us), in that bidders competed for a standardized, pre-specified product—a slice of a utility's retail load—via an open, transparent process that is administered by an independent third party under close supervision of the state regulatory commission. The Maryland process also had many of the same attributes of Ameren's proposed process, such as posting all information on a website and pre-qualifying bidders using publicly available criteria. In addition, winning bids were selected solely on price alone and based on fully pre-specified selection criteria. As a result of these and other features, FERC concluded that the Maryland commission competitive bid process satisfied its concerns regarding affiliate abuse and, more particular, satisfied FERC's four principles for competitive solicitations.[40]

Q. Has the FERC disapproved any affiliate sales made pursuant to a state-supervised competitive procurement for generation service?

A. I am not aware of any instance of FERC rejecting an affiliate power sale resulting from a fully pre-specified, independently managed competitive procurement for

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38 Consolidated Edison Energy, Inc., 102 FERC ¶ 61,097 (2003) (emphasis added).

39 Allegheny Energy Supply Co., LLC, 108 FERC ¶ 61,082 (2004) (Allegheny).

40 Allegheny at P 21.

restructured utilities' regulated service obligations. However, an affiliate agreement from one such procurement effort was recently set for hearing by FERC. The transaction involves a power sale from Conectiv Energy Supply Inc. ("CESI") to its utility affiliate, Delmarva Power & Light Company ("Delmarva"), to supply Delmarva with full requirements service to fulfill their retail load obligation in Virginia.[41] Delmarva held a competitive solicitation to procure generation service for its standard offer service customers and chose CESI. Delmarva's competitive solicitation was modeled after that used in Maryland but with one notable difference: the auction was administered by Delmarva rather than an independent third party. FERC found Delmarva's RFP did not meet the oversight principle announced in Allegheny and, for that reason, ordered that the contract be examined in a hearing.[42]

Our proposal does not suffer from the same deficiency because here the auction has been designed and will be administered by an independent Auction Manager. We will neither run the auction nor determine the winning suppliers. In addition, the auction will be conducted under the supervision of the Staff and an independent Auction Monitor. Thus, our proposal will clearly and fully meet the oversight principle and the other requirements set forth by FERC. We have every confidence that any affiliate supply contract that may result from the competitive procurement process will be approved by FERC.

Q. Does this conclude your testimony?

A. Yes, it does.

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41 Conectiv Energy Supply, Inc., 109 FERC ¶ 61,385 (2004).

42 Id., P 18.